

**House Committee on Ways and Means, Subcommittee on Oversight
Questions for the Record from Chairman Boustany and Response from
Ms. Patricia Thompson, Chair AICPA Tax Executive Committee
American Institute of CPAs**

- 1. Your written testimony highlighted the complexity of determining eligibility for the small business tax credit. In fact, the IRS instructions to Form 8941 alone are eight pages long.**

What kind of feedback have small businesses been giving you on the value of this credit? Also, please comment on the costs small businesses incur to determine and maintain eligibility for the credit? As a percentage of time spent by a paid professional on the return?

As I stated at the hearing, for the taxpayers who perfectly fit within the narrow constraints of the law, the credit is helpful. However, for many small employers, tax compliance costs were created without an offsetting benefit. As stated by one of my colleagues, “many times there was a lot of work for not a lot of return.”

The AICPA does not gather any specific data with regard to the costs small businesses incur to determine and maintain eligibility for the credit. However, our members have told me that it was not uncommon this year for tax preparers to have spent up to 20% of the time necessary to prepare an entire small business return just on the credit calculation, only to learn that the client did not even qualify for the credit. As such, many small employers felt the entire process was a fruitless effort or wasted expense.

- 2. In her written testimony, Ms. Ingram mentioned IRS outreach efforts such as mailings, webcasts, and town halls. IRS has made significant efforts to move forward to get information out to tax preparers and small businesses to raise awareness about the credit. Yet, with all this, participation seems too low at this early stage.**

Is this attributable to insufficient outreach and information being given to small businesses, or is it because the credit is just too complex and small businesses have not taken the credit because of the complexity and cost?

Our members thought the IRS should be complimented on providing guidance on the application of the credit and also on informing taxpayers and tax professionals on the availability of the credit. We do not think the low participation is due to insufficient outreach or insufficient information.

Many small businesses had not filed their tax returns through this period so it is too early to tell if the actual participation for 2010 will be low. However, our members found that the credit’s application was narrowly defined resulting in many of their clients not being able to take advantage of the credit. Other reasons for not claiming the credit may include that the small business owner did not seek professional assistance to understand the impact of the credit on their particular situation or may have decided that the cost of preparing the calculations outweighed the benefit to be received from the credit. Others may not have purchased health insurance because they would not be certain until after the end of the year that they would be eligible for the credit. The credit is complex and the AICPA’s Tax Policy Concept on Guiding Principles for Tax Simplification states that complexity may lower levels of voluntary compliance.

- 3. In your written testimony you mentioned that small businesses are often disproportionately hurt by the complexity of the tax code, because they are unable to hire or they do not have the resources to hire the number of tax preparers, accountants, lawyers, and advisors to navigate through the code.**

Also, the tax code is not even consistent in defining a small business. For example, the research credit defines “small business” as one with 500 or fewer employees, but for the purposes of an Archer Medical savings account, a business with fewer than 51 employees is a small business.

Please comment on how the tax code’s complexity affects small employers, and how the small business tax credit adds to that complexity.

Many small businesses find tax compliance challenging as they lack the resources to comply with the rules. Unlike larger businesses that have dedicated staff to handle payroll, accounting, and tax issues – many small business owners handle all of these functions in addition to running the business.

The small business tax credit clearly adds complexity to the Code. For example, the definitions of eligible small employer, full-time equivalent employees, average annual wages, and employee are not straightforward or consistent with other provisions of the Code. Additional complexity results from the phase out of the credit based on the number of employees and average annual wages. Calculating the employee hours of service also made the credit difficult to apply as the number of annual hours worked by employee is often not readily available. Furthermore, the use of current year information did not provide an incentive for the small business owner to purchase health insurance during the year since they did not know until after the end of the year whether or not they would receive the benefit of the credit.

There is also no quick method for small businesses with more than ten employees to determine if they are eligible. Instead, small businesses sometimes incurred significant time in gathering information. Then, the CPAs had to spend time on analyzing the data and performing the calculations.

If the credit were made simpler, many small businesses could spend less time gathering data. More importantly, the ability to determine eligibility early in the year would provide an incentive for small businesses to purchase health insurance for employees.

- 4. In your written testimony you explained how the small business tax credit did not provide an incentive for small businesses to provide health insurance. If the employer is even aware of the credit, you mentioned that they are not likely to know whether their business is eligible for the credit and if so, the size of the credit until after the end of the year. Please elaborate on this point.**

The primary problem is that employers cannot determine whether they will be eligible for the credit until the end of the year, after they have already made the decision whether to purchase health insurance. As previously mentioned, there is no quick method for small businesses with more than ten employees to determine if they are eligible. These small businesses generally must wait until after the end of the year in order to know their number of employees, the exact number of hours worked per employee, and the actual wages per employee. All of this information is necessary to determine eligibility for the small business health insurance credit.

One simple step to help achieve simplicity would be to use prior year data instead of current year data. In addition, the AICPA recommends that you consider basing the definition of small business on gross receipts. Instead of gathering information on its number of full-time equivalent employees or its average annual wages, the small employer could use the gross receipts amount reported on its prior year tax return.